

 **METALS & MINING**

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Ferrous: Read-across from Baosteel and Vale analyst calls

- China's steel demand recovery delayed to end-Q2CY22 but full-year growth outlook still achievable
- China's policy of balancing demand-supply means steel margin could stabilise in H2CY22 with improvement in coking coal/iron ore supply
- Steel industry transformation plan to high-quality development positive for healthy regional margins

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Recovery delayed but CY22 growth outlook still achievable: While China's steel demand is running below expectations over March-May, Baosteel anticipates a pickup in demand from late Q2 onward supported by pent-up demand, and still considers China's annual GDP growth target of 5.5% to be achievable. Separately, politburo statements also signify strong commitment to the annual targets and the possibility of a stimulus to counter the effect of zero-Covid. Vale also highlighted improving iron ore demand from China with an uptick in blast furnace utilisation.

China may not disrupt ex-China market balance in 2022: China has explicitly reiterated plans for demand-supply balancing in its 7 Feb 2022 policy. Further, on 19 April, central agency NDRC announced its plan to continue with a YoY cut in steel production to drive emission reductions. While Baosteel sees the possibility of a rise in exports near-term from muted levels in Q1 (13.2mt, -25% YoY), China still targets a slight decline in exports YoY.

Potential steel margin stabilisation in H2: Baosteel's average profit per tonne of steel improved to US\$ 73/t over January-March from US\$ 23/t in October-December but was still below US\$ 97/t a year ago. The company expects margins to stabilise as demand recovers, prices ease for iron ore and steel scrap as the wet season draws to an end in Australia and Brazil, and alloy prices come off peaks. However, Baosteel still sees a tight balance in the coke market.

China transformation in progress: Baosteel's 2022-27 strategy targets consolidation, upgrading the steel industry and delivering on China's target of low-carbon steel. It focuses on M&A to drive growth, development of advanced steel materials and sets material emission reduction targets, well ahead of China's deadline.

Read-across for Indian ferrous players: Measures to support recovery and control exports reinforce our outlook on healthy Indian steel margins. The transformation of China's steel industry focus from volume growth to high-quality development is also positive to support long-term regional steel margins in a healthy range.



We summarise key takeaways from Baosteel (600019 CH) CY21 and CY22 Q1 results and analyst call, Vale (VALE3 BZ) Q1 CY22 results and from China politburo meetings from last week of April.

Baosteel CY21 and CY22 Q1: Additional takeaways

2022 growth target still achievable

For 2022, demand will be supported by acceleration of infrastructure investments and stabilisation of real-estate. This will also in-turn result in pick-up in demand from construction and heavy equipment and domestic home appliance segments. Baosteel also expects automotive segment to continue to see improvement post pandemic, with a support from pent-up demand although chip-shortages and raw-material costs could pose headwinds.

China transformation seems real

The Baosteel 2022-27 strategy is weaved around policy aims of consolidation, upgrading of steel industry and delivering on target of low-carbon steel. Baosteel plans to focus on M&A to grow capacity from c50mt to 80mt/100mt by 2024/27 in line with policy for consolidation. Further, it is working on overseas growth opportunities (eg MoU with Saudi Arabia for heavy plate plant). Baosteel is focusing on automotive steel and silicon steel to raise proportion of differentiated products to 51%/ 61%/ 66% by 2022/ 24/ 27. Baosteel aims to achieve carbon peak by 2023 and targets carbon reduction of 8% by 2025 and 30% by 2035 and achieve carbon neutrality by 2050.

Carbon reduction goals are backed by material targets and steps

- Baosteel aims to deliver 8% carbon reduction by 2023 by initiating substitution of carbon energy with green energy, achieving best-in-class efficiency across its production plants and increasing usage of scrap. To deliver on 30% reduction, Baosteel will additionally look to deepen usage of green energy, use of high efficiency EAF and hydrogen (H₂)-rich shaft furnace. For achieving carbon-neutrality by 2050, Baosteel will look to implement H₂-rich carbon cycle BF, all H₂ shaft furnace and increase usage of high efficiency EAF and green energy.
- Baosteel is targeting two demonstration projects – a) all-hydrogen zero-carbon green demonstration production line i.e. an 1.8mtpa H₂-based shaft furnace at Zhanjiang by 2023 and b) a high-efficiency EAF by 2024. Baosteel is also working to complete zero scrap-generation at one of the plants.

Automotive steel: transformation to low-carbon targeted globally

Automotive steel applications have become a global focus for transition to low-carbon primarily due to demand from consumers and a majority (>90%) of supply from BF+BOF route, wherein carbon reduction is a greater challenge.

Global majors are focusing on this transition and dozens of demonstration lines with 20mt of aggregate capacity are under various stages of development. The transition would require use of green hydrogen and green electricity. However, the biggest challenge for this transition is a lack of mature technology for commercial application.

Commercial-scale investment needs to be timed appropriately as first mover may be at a disadvantage.

Fig 1 – Low-carbon automotive demonstration plants under development

Company	Capacity	Approach	Timeline
American Steel Union	Megaton	EAF+ESP	2024-25
Thyssen	100kt	DRI+EAF	2025-26
Nippon Steel	Megaton	Scrap+EAF	2025-26
AMNS	Megaton	H-DRI+EAF	2025-26
POSCO	Megaton	DRI+EAF	2025-26
SSAB	Megaton	H-DRI+EAF	2026-27

Source: Company, BOBCAPS Research

Vale Q1 CY22 – Key takeaways

Vale had missed Q1 production guidance, like its Australian peers. Vale delivered 63.9mt iron ore sales in Q1, below consensus of 67.8mt. Vale attributed the miss to licensing delays at Serra Norte, underperformance at S11D and Sossego, and major maintenance work besides the impact of heavy rains at Minas Gerais in Jan'22.

Vale sees improving iron ore demand from China. Vale is not seeing any issue with iron ore demand from China despite the Covid related restrictions in China. Vale highlights increasing blast furnace utilisation in China over past couple of weeks.

Vales comments imply good possibility of improvement in iron ore supply in H2 CY22. Vale reiterates its CY22 guidance of 320-335mt, maintaining a wide-range. To avoid the misses (of guidance) as we have seen over past two years, Vale is attempting to finish major works in H1 (wet season) at the North Range to improve its availability during the dry season of H2 CY22. As an example, they replaced conveyor belt in Q1 and installing crushers in H1 at S11D. Further, improved availability of the South and Southeastern system could also help during H2. However, any further licensing delays at Serra Norte could pose a downside risk.

China politburo meetings in last week of Apr'22: Key takeaways

Politburo's statement on 29 Apr'22 signifies a strong commitment to deliver its CY22 growth target of 5.5% despite Covid-Zero policy, which possibly imply an additional stimulus to support economy. Separately, the Chinese government plans to promote infrastructure construction in all-round boost to domestic economic and social development, according to a top economic meeting chaired by President. Some of the relevant statements (Source: www.xinhuanet.com) –

- *We must stay confident, overcome difficulties and ensure that the CPC Central Committee's major policies are carried out to the letter.*
- *We will step up macroeconomic adjustment to stabilize the economy, meet the objectives set for economic and social development in 2022, and keep major economic indicators within an appropriate range. We will move faster to implement established policies, press ahead with tax refund and reduction and fee cuts, and better use a range of monetary policy tools, according to the meeting.*

- *We will promptly design additional policy tools, strengthen well-timed regulation, and make sure goal-oriented policies are formulated in a timely manner and given some leeway.*
- *We will make all-out efforts to expand domestic demand, give full play to the role of effective investment, ensure support for projects in terms of land and energy use as well as environmental impact assessment, and advance infrastructure development across the board. We will give full play to the role of consumption in facilitating economic flows.*
- *The political bureau stressed the need to effectively control major risks and guard against systemic risks. Housing is for living in, not for speculation. Greenlight should be given to local governments to improve their real estate policies according to their specific conditions. People's demand for buying their first homes and improving housing conditions should receive due support. The oversight on advance payment for commodity housing should be optimised.*

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